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DEPARTMENT OF STATE REVENUE
FIRST SUPPLEMENTAL LETTER OF FINDINGS : 95-0569 RST

Use Tax — Environmental Quality Exemption
Tax Administration — Penalty
For Tax Periods: 1992, 1993, and 1994

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ISSUE

I. Use Tax — Environmental Quality Exemption

Authority: IC 6-2.5-5-30;
45 IAC 2.2-5-38

Taxpayer protests the assessment of use tax on its purchase of laboratory and testing equipment, as well as on its purchase of certain supplies and chemicals.

II. Tax Administration — Penalty

Authority: IC 6-8-10-2.1;
45 IAC 15-11-2

Taxpayer protests the imposition of a ten-percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer performs a variety of environmental tests for its customers. In order to perform these testing activities, taxpayer purchased supplies, chemicals, and laboratory and testing equipment. As sales tax was not paid when taxpayer purchased these items, Audit assessed use tax on these purchases. Taxpayer protested these assessments as well as the imposition of a ten percent

(10%) negligence penalty. As the result of an October 1996 hearing conducted with the Department, taxpayer's use tax and penalty protests were denied. Taxpayer then requested, and was granted, a rehearing. The following findings are a result of that rehearing.

I. Use Tax — Environmental Quality Exemption

DISCUSSION

Taxpayer makes two (2) arguments in support of its position that use tax should not have been assessed on its purchase of supplies, chemicals, and equipment. First, taxpayer argues that IC 6-2.5-5-30 (the environmental quality compliance statute) provides taxpayer an exemption for its supplies, chemicals, and equipment purchases.

As the relevant portion of IC 6-2.5-5-30 instructs:

> Sales of tangible personal property are exempt from the state gross retail tax if:
>
> > (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with state, local, or federal environmental quality statutes, regulations, or standards; and
> >
> > (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

Taxpayer argues that under the listed elements of IC 6-2.5-5-30(1), taxpayer purchases should have been exempt from Indiana sales and use taxes. Taxpayer reasons that since its equipment, chemicals, and supplies were used in tests which were necessary to ensure "compl[iance] with state, local, or federal environmental quality statutes, regulations, or standards," the exemption should apply.

Additionally, taxpayer notes that if taxpayer's customers had purchased these items, the exemption provided by IC 6-2.5-5-30 would have applied.

Taxpayer performs a variety of environmental tests – tests involving soil, air, and water. While taxpayer's clients may be "in the business of manufacturing, processing, refining, mining, or agriculture," taxpayer is not. Rather, from a description of its activities, taxpayer is a service provider. And as a service provider, taxpayer is not engaged in those types of activities covered by the language of IC 6-2.5-5-30(2). Consequently, taxpayer does not qualify for the exemption.

Taxpayer's reading of the statute may be overbroad as well. Taxpayer argues, in equity, that if taxpayer's customers had purchased these items, the exemption provided by IC 6-2.5-5-30 would have applied. In response, the Department notes that while "testing" is certainly a prerequisite for determining whether one is in compliance with environmental quality control standards, testing is not necessarily a function of compliance.

Second, taxpayer seeks shelter under the umbrella of IC 6-2.5-5-5.1, which provides an exemption for materials consumed in the direct production of other tangible personal property.

Specifically, IC 6-2.5-5-5.1(b) provides for the following exemption.

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct consumption as a material to be consumed in the direct production of other tangible personal property in his business of manufacturing, processing, refining, repairing, agriculture, horticulture, floriculture, or arboriculture.

As a result of its testing services, taxpayer creates a report for its customers indicating the test outcomes. Taxpayer has characterized this report as tangible personal property and consequently, its activities as the "production of tangible personal property." Taxpayer reasons, therefore, that all tangible personal property "consumed" in its testing procedures should be exempt from sales and use taxes pursuant to IC 6-2.5-5-5.1(b).

The Department, however, considers taxpayer to be a service provider. Taxpayer is not engaged in the "direct production of other tangible personal property." While taxpayer creates a report containing the results of its environmental tests, this report is provided to only the client for whom the tests are performed. In this context, the preparation and distribution of a report becomes incidental to the provision of testing services. This is not a situation where taxpayer compiles data from a variety of sources and then creates a report intended, and marketed, to larger audiences. Furthermore, the Department notes that taxpayer is not engaged in the business of "manufacturing, processing, refining, repairing, agriculture…" Consequently, taxpayer may not invoke the exemptions provided by IC 6-2.5-5-5.1.

FINDING

Taxpayer's protest is denied.

II. Tax Administration — Penalty

DISCUSSION

The taxpayer protests the imposition of the ten-percent (10%) negligence penalty.

The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(e).

Taxpayer argues that the penalty should not apply as taxpayer relied on the advice of its accountants when determining whether use tax should be self-assessed on the contested items. Reliance on the advice of accountants – accountants who should have known that use tax was to be assessed on these items – does not rise to the level of reasonable cause. The Department finds, therefore, that imposition of the negligence penalty is appropriate.

FINDING

Taxpayer's protest is denied.